

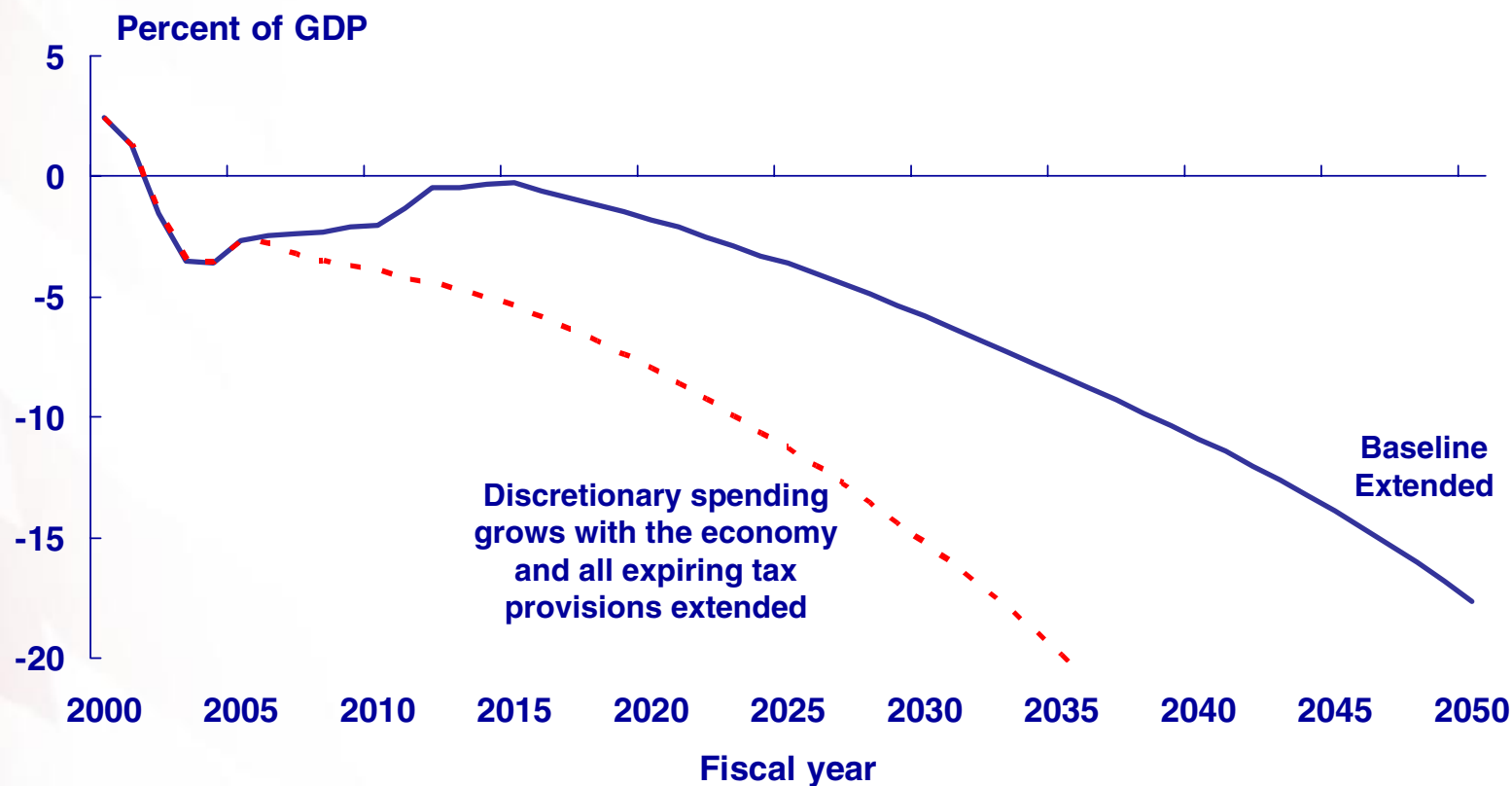
Interpreting Long-term Simulations

- Long-term simulations provide illustrations--not precise forecasts--of the relative fiscal and economic outcomes associated with alternative policy paths.
- Long-term simulations are useful for comparing the potential outcomes of alternative policies within a common economic framework over the long term.
 - Recognizing the inherent uncertainties of long-term simulations, we have generally chosen conservative assumptions, such as holding interest rates and total factor productivity growth constant. Variations in these assumptions generally would not affect the relative outcomes of alternative policies.
 - The model simulates the interrelationships between the budget and the economy over the long term and does not reflect their interaction during short-term business cycles.
- Long-term simulations are not predictions of what will happen in the future. In reality, policymakers likely would take action before the occurrence of the negative out-year fiscal and economic consequences reflected in some simulated fiscal policy paths.

Alternative Fiscal Policy Simulations

- **Baseline extended** follows CBO's August 2005 10-year baseline projections which assume that discretionary spending grows with inflation and tax provisions scheduled to expire will actually do so. After 2015, discretionary spending is assumed to grow with the economy, and revenue is held constant as a share of GDP at the 2015 level of 19.5 percent.
- **Discretionary spending grows with GDP after 2005 and all expiring tax provisions are extended** follows CBO's August 2005 10-year baseline projections except that discretionary spending grows with the economy after 2005 and all expiring tax provisions are extended. After 2015, revenue is held constant as a share of GDP at the 2015 level of 17.4 percent.
- After the first 10 years, in both simulations
 - Social Security and Medicare spending is based on the March 2005 Trustees' intermediate projections. Medicaid spending is based on CBO's December 2003 long-term projections under mid-range assumptions.
 - Social Security and Medicare benefits are paid in full after the trust funds are exhausted through borrowing from the general fund to meet any payroll tax shortfall.

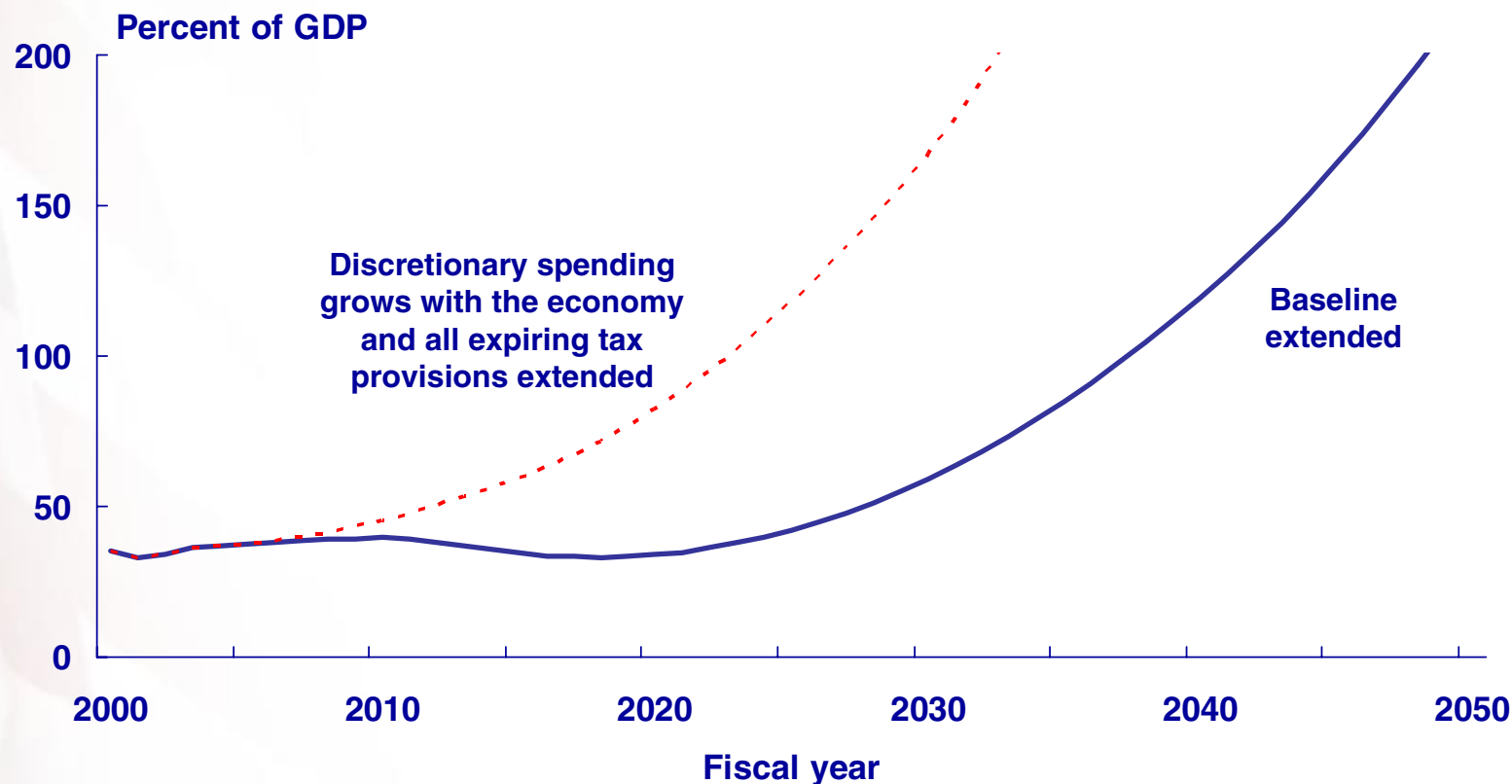
Unified Surpluses and Deficits as a Share of GDP Under Alternative Fiscal Policy Simulations



Note: Assume currently scheduled Social Security benefits are paid in full throughout the simulation period.

Source: GAO's August 2005 analysis.

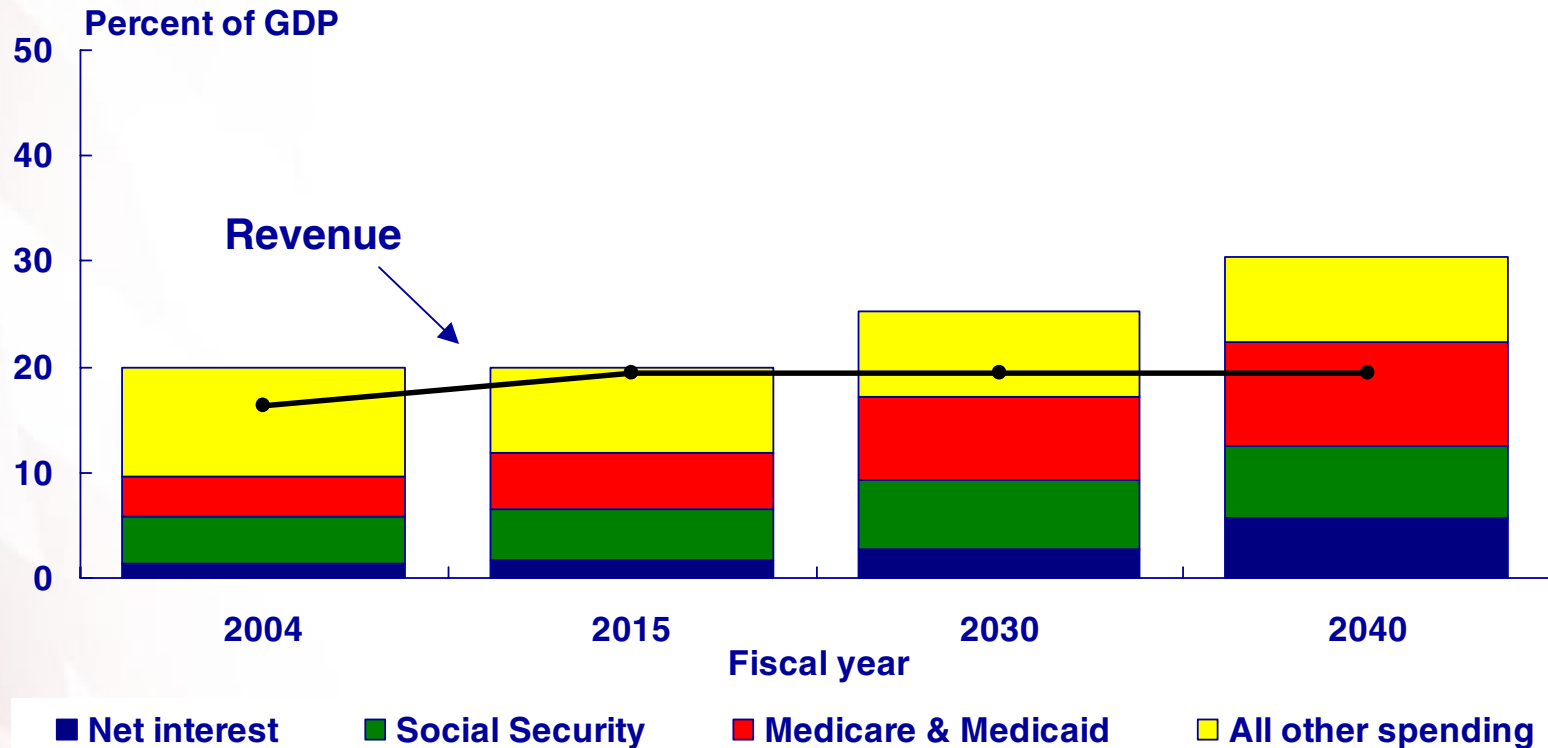
Debt Held by the Public as a Share of GDP Under Alternative Fiscal Policy Simulations



Note: Assume currently scheduled Social Security benefits are paid in full throughout the simulation period.

Source: GAO's August 2005 analysis.

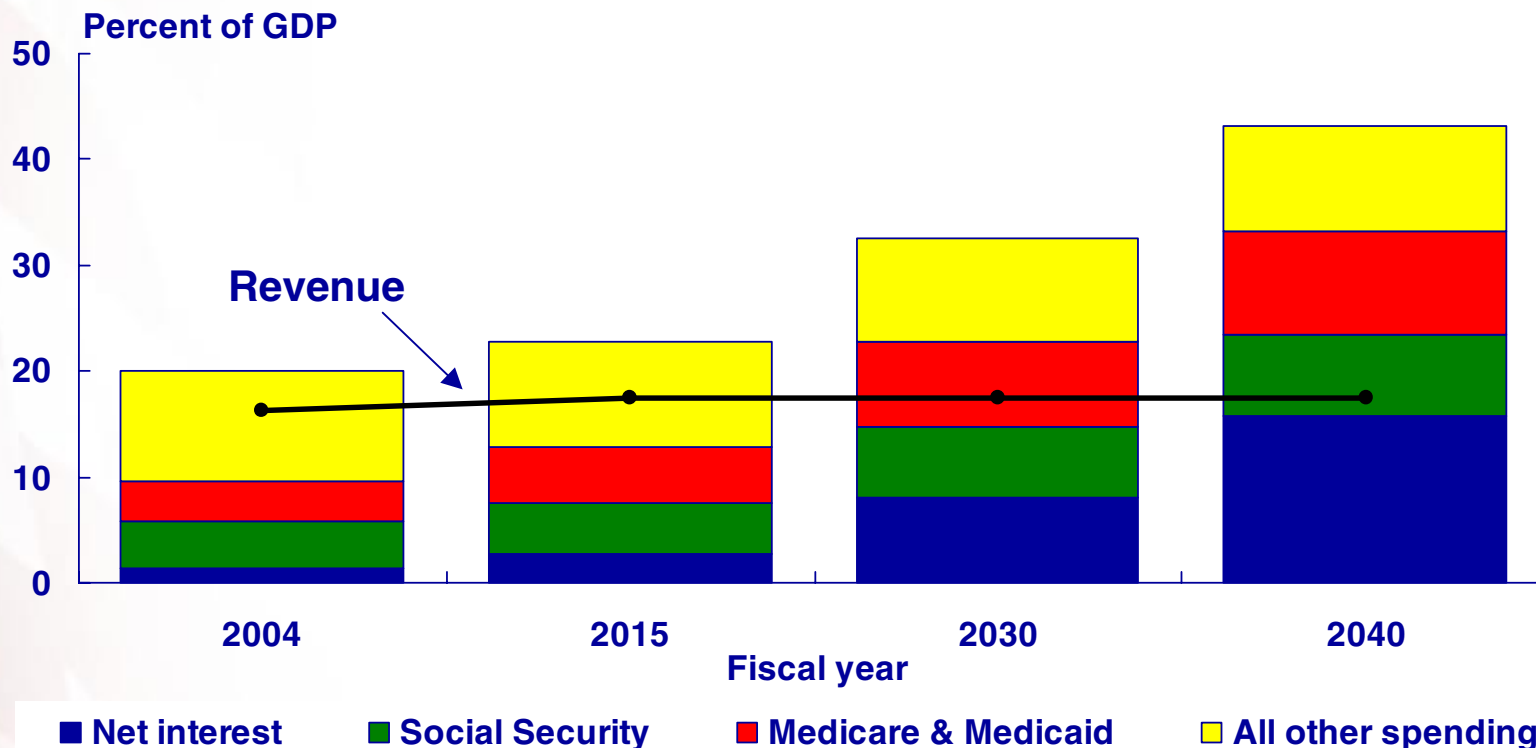
Composition of Spending as a Share of GDP Under Baseline Extended



Notes: In addition to the expiration of tax cuts, revenue as a share of GDP increases through 2015 due to (1) real bracket creep, (2) more taxpayers becoming subject to the AMT, and (3) increased revenue from tax-deferred retirement accounts. After 2015, revenue as a share of GDP is held constant.

Composition of Spending as a Share of GDP

Assuming Discretionary Spending Grows with GDP After 2005 and All Expiring Tax Provisions are Extended



Notes: Although expiring tax provisions are extended, revenue as a share of GDP increases through 2015 due to (1) real bracket creep, (2) more taxpayers becoming subject to the AMT, and (3) increased revenue from tax-deferred retirement accounts. After 2015, revenue as a share of GDP is held constant.

Source: GAO's August 2005 analysis.

Key Model Assumptions Under Baseline Extended

Model inputs	Assumptions
Surplus/deficit	CBO's August 2005 baseline through 2015; GAO simulations thereafter
Social Security spending (OASDI)	Based on 2005 Social Security Trustees' intermediate projections, adjusted for economic growth in each alternative simulation
Medicare spending	CBO's August 2005 baseline through 2015; thereafter based on 2005 Medicare Trustees' intermediate projections, (per enrollee Medicare spending assumed to grow over the long term with GDP per capita plus 1 percent).
Medicaid spending	CBO's August 2005 baseline through 2015; thereafter based on CBO's December 2003 long-term projections under Scenario 2 (per enrollee Medicaid spending assumed to grow over the long term with GDP per capita plus 1 percent).
Other mandatory spending	CBO's August 2005 baseline through 2015; thereafter increases at the rate of economic growth (i.e., remains constant as a share of GDP)
Discretionary spending	CBO's August 2005 baseline through 2015; thereafter increases at the rate of economic growth
Revenue	CBO's August 2005 baseline through 2015; thereafter remains constant at 19.5 percent of GDP (CBO's projection in 2015)
Nonfederal saving: gross saving of the private sector and state and local government sector	Increases gradually over the first 10 years to 18.7 percent of GDP (the average nonfederal saving rate from 1950-2004)
Current account balance (percent of GDP)	From 2005-2015, 2004 share of GDP plus one-third of any change in gross national saving from 2004; thereafter equal to 2015 nominal level plus one-third of any change in gross national saving from 2004
Labor: growth in hours worked	2005 Social Security Trustees' intermediate projections
Total factor productivity growth	1.4 percent through 2015 (CBO's August 2005 short-term assumption); 1.4 percent thereafter (long-term average from 1950-2004)
Inflation (percent change in GDP price index)	CBO August 2005 baseline through 2015; 1.8 percent thereafter (CBO's projection in 2015)
Interest rate (on publicly held debt)	Rate implied by CBO's August 2005 baseline net interest payment projections through 2015; 5.2 percent thereafter (the rate implied in 2015)

Notes: These assumptions apply to our base simulation, Baseline Extended. For alternative fiscal policy simulations, certain assumptions are varied, which are noted in the discussion of the alternative paths.

Source: GAO's August 2005 analysis.